

Securities Regulation Daily Wrap Up, FRAUD AND MANIPULATION—E.D. Mich.: Ponzi scheme operator ordered to pay over \$121 million, (Feb. 3, 2014)

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By Amanda Maine, J.D.

A federal court granted an SEC request to order the perpetrator of a Ponzi scheme to pay more than \$121 million in disgorgement, penalties, and prejudgment interest. The defendant had offered promissory notes to investors, which he had represented would be used for oil-related investments, but instead were used to finance a Ponzi scheme and to fund his lavish lifestyle (*SEC v. Zada*, January 31, 2014, Hood, D.).

Background. Joseph Paul Zada and his company, Zada Enterprises LLC, (collectively, “Zada”) offered and sold promissory notes to investors, representing to them that funds would be invested in oil-related ventures and that they would see gains ranging from 15 to 40 percent with little risk. According to the SEC, Zada did not use the funds for oil-related investments. Instead, he used some the funds to pay “interest” and principal to previous investors, and the rest to finance his extravagant lifestyle and to pay personal expenses unrelated to the alleged oil investments. In November 2010, the SEC filed a civil complaint Zada alleging that the Ponzi scheme violated the federal securities laws. A federal court granted the SEC’s motion for summary judgment on July 13, 2013. The SEC then filed a motion for damages requesting disgorgement, prejudgment interest, and a civil monetary penalty.

Disgorgement and interest. The court noted that the purpose of disgorgement is not to compensate victims of fraud, but to deprive the wrongdoer of his ill-gotten gains. In calculating disgorgement, the amount need only be a “reasonable approximation of profits causally connected to the violation,” the court advised. The SEC in its request for disgorgement detailed three components of Zada’s ill-gotten gains, which totaled more than \$56.5 million. According to the court, that amount removed Zada’s ill-gotten gains and there was no error in the SEC’s computation. In addition, Zada, who had in a previous hearing noted that it would be imprudent to actively defend against the SEC’s action due to pending criminal charges, filed no objection to the amount. The court granted the SEC’s disgorgement request. The court also granted the SEC’s request for over \$8.5 million in prejudgment interest, reiterating that it found the SEC’s proposed calculations appropriate.

Civil penalty. In addressing the SEC’s request for a civil monetary penalty, the court described several factors to consider, including the egregiousness of the violations, the isolated or repeated nature of the violations, the degree of scienter involved, the sincerity of the defendant’s assurances against future violations, the defendant’s recognition of the wrongful nature of his conduct, the likelihood that the defendant’s occupation will present opportunities for future violations, and the defendant’s age and health.

The court also noted that there are three tiers of penalties based on the degree of a defendant’s culpability, the third of which relates to violations involving fraud and deceit that caused or risked substantial losses. Given these criteria, the court stated that based on the large amount of the funds involved, the egregiousness of Zada’s actions, the high degree of scienter, and Zada’s apparent lack of remorse or acceptance of fault, a civil penalty under the third tier is appropriate. The court also noted that the violations were not isolated, and that Zada’s occupation and age (55) could present opportunities for continued violations.

The SEC’s request had asked for a civil monetary penalty, the amount to be determined at the court’s discretion. Citing federal law that limited the amount of penalty for each third-tier penalty to the “the gross amount of pecuniary gain to the defendant as the result of the violation,” the court imposed a monetary penalty in the same amount as the disgorgement, over \$56.5 million.

The total amount Zada must pay in disgorgement, prejudgment interest, and the civil monetary penalty is \$121,658,000.

The case is No. 10-CV-14498.

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